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SUBJECT: FALLOUT FROM GLOBAL FINANCIAL CRISIS HITTING SOUTH INDIA,
TOO

¶1. (SBU) Summary: Our contacts in South India remain largely optimistic about the longer-term trajectory of the region's economy, but they are bracing for a rough ride in the short-term. Banks are tightening credit, importers are facing rising costs as the rupee drops, and exporters are not benefiting from the lower rupee as their markets in the West soften because of the financial crisis. Even South India's vaunted high-tech sector may have to tighten its belt as it faces challenges it has not had to deal with before. Nevertheless, South India's business still appear relatively optimistic about their longer-term prospects. End summary.

South Indian Banks tighten credit . . .

¶2. (SBU) Several Indian banks base themselves in South India, notably Canara Bank, Vijaya Bank and Syndicate Bank. Our contacts tell us that they are becoming stingier with their lending, scaling back credit limits and scrutinizing potential lenders more closely. The Managing Director of Syndicate Bank, for example, told us that his bank had tightened credit controls by moving decision making to higher levels. He also said that his bank was seeking to limit exposure in western markets by focusing more closely on its core market, which consists mainly of serving entrepreneurs based in and around Bangalore. A Citibank official told us that his company was already scaling back credit limits for some of its corporate clients it thinks are currently vulnerable.

¶3. (SBU) A top Ford-India executive told us that the company's customers are finding it nearly impossible to get car loans from banks. He added that Ford's finance arm was operating successfully, and that about 80 percent of Ford's dealers already regularly secure loans for customers through it. Given current conditions, he said, "the other 20 percent are asking us how to join."

¶4. (SBU) The project director for the infrastructure company charged with building Hyderabad's metrorail system (a USD 3-4 billion project) told us that his company planned to deliver the project on time, but complained that the current financial environment was unhelpful. He said that the project is currently working on securing financing and that he doubts that any U.S. banks will be willing to lend to such a project. He told us that he would need to rely on Indian banks to provide the funding, but complained that this financing would be at a higher rate, raising costs.

. . . And look for money in all kinds of places

¶5. (SBU) Some banks are also working hard to shore up their deposits. A Canara Bank board member told us that his bank had succeeded in strengthening its capital base through a "deposit mobilization program" that targeted high-net-worth individuals based in Bangalore. He also said that he is confident that South India's banks will remain solvent even if the financial markets collapse in the West.

¶16. (SBU) Other banks are apparently pursuing potential depositors, as well. An owner of a Chennai-based manufacturing outfit laughed as he told us that several local banks had approached his company in recent weeks looking to borrow money, a situation he found rather ironic.

Importers see costs jump as rupee drops

¶17. (SBU) While Indian exporters may cheer the rupee's recent drop against the dollar, manufacturers of computers and automotive parts who source components -- generally priced in dollars -- from outside India have seen their margins shrink. An executive at Dell's manufacturing center in Chennai told us that he is struggling to keep costs down as the relative price of imported components shoots up. He said that Dell increased the price of its computers by eight percent in the Indian market in mid-October yet saw its margins shrink as the rupee dropped. A Visteon executive, whose company manufactures and assembles automotive components in Chennai, told us that he was similarly having difficulties controlling costs, since many of the sub-components his company sources are from suppliers located in places like Thailand that price in dollars.

Exporters not faring well, either

¶18. (SBU) Despite the rupee's fall, textile and leather exporters are witnessing a drop in demand as their markets -- generally in the West -- soften. A contract manufacturer of high-end lingerie told us that demand for the holiday season has dropped 50 percent from last year. He said that he had to reduce the number of shifts at his facility from three to one and lay off half of the 2000

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employees that his company usually employs.

¶19. (SBU) A shoe manufacturer, who exports shoe uppers to Western markets, gave a similar account of the current situation. He said that Christmas orders from large stores in U.S. and Europe had dropped by over 40 percent from last year. He explained that this is usually the best time of the year for his company but admitted that many orders he has been expecting have not materialized. He also predicted that many of the small, local producers of shoe upper units that survive by doing piece work will close by the year end.

IT companies don't expect to be immune

¶10. (SBU) The pinch is even being felt by India's software giants whose greatest management challenge hitherto has been trying to manage effectively their rapid growth. Several of them have begun scaling back their revenue projections for the next two to three quarters. An Infosys executive told us that his company announced with a lowered revenue forecast because they remain unsure if some contracts that were currently being negotiated would actually materialize. He also said that decision-making in the company's large clients had become more centralized, requiring more time to seal deals and get customers' decisions. The top executive at a medium-sized software developer said that some of its key clients (often U.S. firms) were deferring decisions on contracts. He said that the company is not only scaling back expansion plans, but also looking at reducing its head count.

¶11. (SBU) One high-tech company that may be bucking the trend, however is IBM. An executive with IBM-India told us that his company had made no changes to its investment plan for India. (Worldwide, IBM has continued to be one of the bright spots in the world economy, announcing in early October that its Q3 earnings were up 22 percent.) He even noted that hiring new talent had become easier in the current environment.

¶12. (SBU) An executive at Dell's call center in Hyderabad told us that the situation for his company was "getting more challenging." He said that he probably would not need to lay people off, but that he probably would need to reduce his employee count by not replacing people lost through attrition. He said that he is employing 3500

people in Hyderabad now and that he thinks his numbers could drop to 3000 by Q3 in 2009. He added that his contacts in companies like Infosys and Wipro are really worried, because they do a lot of business with finance and insurance firms, noting that he would not be surprised if they had to start laying people off. On the plus side, he noted that employees had taken note of the economic situation and were not quitting as much, lowering attrition -- a costly and chronic problem in this sector.

Not all doom-and-gloom

13. (SBU) Despite the worldwide financial crisis, however, many in South India remain optimistic about their companies' chances over the longer term. Many South Indian business groups hold large cash reserves that they believe will see them through. The editor of a business publication owned by one of these family-owned groups said that these reserves, built conservatively over the years, would probably be sufficient to sustain most large South Indian businesses during an economic slowdown. He did, however, predict a potentially turbulent shakeout in the IT and financial services sector, while maintaining that manufacturing enterprises stand a better chance of weathering the storm.

Comment

14. (SBU) There's no question that the current financial and economic situation is causing concern in South India, but most of our contacts still seem guardedly optimistic about the future. They recognize that the road immediately ahead may be rocky, but they still believe that the factors that have made the region attractive -- availability of world-class talent, an attractive investment climate (compared with most of the rest of India), and an increasingly large consumer class -- will eventually overcome whatever obstacles are placed by the financial crisis. In the shorter term, too, financing may very well improve as the government and central bank continue to liberalize fiscal and monetary policies aimed at getting financing flowing again to sustain India's growth story.

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